

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

Periodic Reporting  
(NPPC et al. Proposal One)

Docket No. RM2023-3

**MAILER COMMENTS ON  
THE APPROPRIATE ANALYTICAL PRINCIPLE  
FOR RETIREE HEALTH BENEFIT NORMAL COSTS**  
(February 8, 2023)

The undersigned mailer organizations (“Mailers”) respectfully submit these comments<sup>1</sup> in response to the notice of proposed rulemaking in Order No. 6430 regarding the Mailers’ proposal (NPPC *et al.* Proposal One) to attribute to products the retiree health benefit (“RHB”) normal costs that are caused by them.<sup>2</sup> RHB normal costs “represent the present value of the estimated retiree health benefits attributable to active employees’ current year of service.”<sup>3</sup>

Specifically, the Commission should amend the current analytical principle applicable to Cost Component 18.3.6 (Retiree Health Benefits) by removing the

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<sup>1</sup> Although proponents (typically the Postal Service) do not file initial comments on their own proposals, commenters believe that in light of the extensive discussion in Order No. 6430 some additional comments are warranted.

<sup>2</sup> *Motion For Reconsideration Or, In The Alternative, Petition To Initiate A Proceeding Regarding The Appropriate Analytical Principle For Retiree Health Benefit Normal Costs*, Dockets No. RM2023-1 and RM2023-3, at 16 (December 19, 2023) (“*Mailers’ Petition*”).

<sup>3</sup> Order No. 6430, Docket Nos. RM2023-1 & RM2023-3, at 2 (January 25, 2023) (“*Order Denying Request for Reconsideration and Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (NPPC et al. Proposal One)*”) citing *Financial Analysis of United States Postal Service Financial Results and 10-K Statement*, Docket No. ACR2021, at 7, n.9 (May 18, 2022), 88 *Fed. Reg.* 6679 (February 1, 2023).

capping of attributable RHB costs “at the total amount of accounting costs”<sup>4</sup> — hereinafter referred to as the accounting cost cap — because the cap results in costs that are caused by products not being attributed to them. That non-attribution violates the statute,<sup>5</sup> the Commission’s Rules of Practice,<sup>6</sup> and the definition of attributable costs,<sup>7</sup> and therefore should be eliminated.

This change should be adopted because it will “improve the quality, accuracy, or completeness of Postal Service data...whenever it shall appear that—(1) the data have become significantly inaccurate or can be significantly improved; or (2) those revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.” 39 U.S.C. §3654(e).

## **I. THE PROPOSAL**

In their petition for rulemaking, Mailers stated:

to the extent the Order No. 6363 interprets the principle as not requiring attribution of accrued RHB normal costs when the Postal Service is under no immediate obligation to pay, the mailers hereby would petition, pursuant to 39 C.F.R. §3050.11, to change that principle.<sup>8</sup>

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<sup>4</sup> Order No. 6430, at 20.

<sup>5</sup> See Postal Accountability and Enhancement Act (PAEA), 39 U.S.C. §3631(b): “[T]he term ‘costs attributable’, as used with respect to a product, means the direct and indirect postal costs attributable to such product through reliably identified causal relationships.”

<sup>6</sup> 39 C.F.R. §3035.107(b): “[T]he Commission will calculate a competitive product’s attributable costs as the sum of its volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a competitive product’s incremental costs.”

<sup>7</sup> See *Annual Compliance Determination, Fiscal Year 2017*, Docket No. ACR2017, at 8 (March 29, 2018) (“In September 2016, the Commission adopted the analytical principle of using incremental costs as the basis for class-level and product-level attributable costs” (footnotes omitted)).

<sup>8</sup> *Mailers’ Petition*, at 16 (December 19, 2023).

To effectuate that principle:

- (1) the Commission must eliminate the restriction, at least as applied to Cost Component 18.3.6 (Retiree Health Benefits), that attributable costs may not exceed accounting costs;
- (2) the estimated RHB normal cost provided by OPM pursuant to 39 U.S.C. §3654 and presented in the Postal Service's 10-K should be the source of the accrued current year RHB normal costs (Component 18.3.6.1), as it reflects the RHB normal costs actually incurred for any given year and has been relied upon in every annual compliance proceeding since PAEA was enacted; and
- (3) as in all past years since enactment of the PAEA, RHB costs (Component 18.3.6) must continue to be disaggregated into components — current year costs (Component 18.3.6.1) and prior year costs (Component 18.3.6.2) — because the causation and thus appropriate attribution methods differ between the two. The prior year RHB costs would be calculated by subtracting the RHB normal cost from the total RHB payment due that year.

Modifying the analytical principles in this way will enable the Commission to continue to attribute incremental RHB normal costs to products consistent with their attribution in previous years in which the accounting cost cap never came into play. And as discussed in Section II below, this approach is fully consistent with how such costs have been treated in prior years.

In FY 2022, even though RHB accounting costs were \$0 according to the Postal Service because no payment was required, the Postal Service did incur RHB normal costs of \$4.4 billion as determined by OPM. Under the Mailers' proposal, the current year costs would be the RHB normal costs, and the accounting costs minus the current year costs would be prior year costs just like

in past years.<sup>9</sup> As in previous years, the current year costs would be distributed to products as a piggyback on direct labor costs and the prior year costs would be treated as entirely institutional.<sup>10</sup> This treatment is shown in Table 1, below.

**Table 1—Mailers Proposed Treatment of FY 2022  
Retiree Health Benefits Costs (\$ billions)<sup>11</sup>**

Cost Component & Description		Accrued	Attributable	Institutional
		[a]	[b]	[c]
<b>18.3.6—Retiree Health Benefits</b>	[1]	<b>\$0.0</b>	<b>\$2.6</b>	<b>-\$2.6</b>
18.3.6.1—Retiree Health Benefits (Current Year)	[2]	\$4.4	\$2.6	\$1.8
18.3.6.2—Retiree Health Benefits (Prior Year)	[3]	-\$4.4	\$0.0	-\$4.4

[1][a] United States Postal Service, *2022 Report on Form 10-K*, at 33

[2][a] United States Postal Service, *2022 Report on Form 10-K*, at 32

[3][a] = [1][a] – [2][a]

[b] Attributed assuming the same percentage as FY 2021 from *Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2021* (July 1, 2022), CS18-21.docx, at 18-2.

Calculating prior year RHB costs in this manner results in FY 2022 (and potentially at least FY 2023 through FY 2025) in a negative accrued prior year RHB cost. As explained in Section III, this is not a problem and is entirely consistent with how these costs have been treated in past years.

<sup>9</sup> This would not require the Postal Service to revise its accounting documents because the sum of current year and prior year RHB accrued costs would remain \$0 nor would it cause total costs to differ between those presented in the 10-K and the Cost and Revenue Analysis.

<sup>10</sup> *Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2021*, CS18-21.docx, at 18-19 & 18-20 (July 1, 2022).

<sup>11</sup> Note that the RHB Prior Year Cost figures in Table 1 omit the impact of Postal Service reform legislation on past-due PSRHBF obligations, which is the subject of a separate pending docket.

In FY 2023 through FY 2025, in which the Postal Service presumably will again receive no invoice from OPM, the procedure would work in the same manner. Starting in the year that the Postal Service receives a “top-off” invoice from OPM (no later than FY 2026), the Postal Service would, presumably, again incur an accounting cost that would flow through to its periodic reports. However, that payment would, as in past years, be separated in Cost Component 18.3.6 into the current year cost (the RHB normal cost estimated by OPM) and the balance, whether negative or positive, treated as a prior year institutional cost.

This approach of removing the accounting cost cap and simply disaggregating RHB costs into its component parts and applying attribution techniques specific to each component’s cost drivers — as has routinely occurred in past years — would improve the quality, accuracy, and completeness of the data in the Postal Service’s periodic reports when compared to the current approach.<sup>12</sup>

## **II. PRODUCT COSTS REPORTED IN THE POSTAL SERVICE’S ANNUAL COMPLIANCE REPORTS HAVE CONSISTENTLY INCLUDED INCREMENTAL RHB NORMAL COSTS REGARDLESS OF THE SIZE OF THE REQUIRED PAYMENT INVOICE THE SERVICE RECEIVED FROM OPM**

Using OPM’s determination of normal costs (done pursuant to 39 U.S.C. §3654) to identify RHB normal costs in Cost Segment 18 of the Cost and Revenue Analysis is not new. The Postal Service has used that figure in its

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<sup>12</sup> There is no dispute between Mailers, the Commission, and the Postal Service regarding what the appropriate attribution approaches are for current year and prior year RHB costs. The Postal Service argues only that the accrued cost for both should be zero.

annual compliance reports since the enactment of PAEA. This consistent practice has been unaffected by the amount OPM has invoiced the Postal Service for RHB costs.

RHB normal costs are earned throughout the year by current postal employees.<sup>13</sup> Each year, in a calculation outside of the invoicing process, OPM estimates the Postal Service's liability for those costs and informs it of the amount. 39 U.S.C. §3654(b)(1). For FY 2022, the OPM calculated the Postal Service's RHB normal costs to be \$4.4 billion.<sup>14</sup>

This determination is explained in more detail in the Postal Service's FY 2008 Summary Description of USPS Development of Costs by Segments and Components (the first after enactment of the PAEA):

The basis for determining the amount of current-year costs is to identify the benefits earned during the fiscal year by current employees. Under a new element of PAEA pertaining to retiree health benefits, OPM will determine the amount of the new obligations incurred each year (39 U.S.C. §8908a[d][1]). The yearly increase in obligations is the change in the net present value of the future retiree health benefits payments during the year. It is the value of the retiree health benefits earned by current employees during the year. While it will not be paid to current employees until they retire, it is part of the compensation to employees, just like salaries and currently paid benefits. OPM's estimate of the present value of the additional obligation taken on during FY 2008 for future payment of retiree health benefit is \$3.389 billion, as will be reported in the Postal Service Annual Report, page 37, shown as Normal Cost.<sup>15</sup>

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<sup>13</sup> See Order No. 6430, at 16.

<sup>14</sup> United States Postal Service, *2022 Report on Form 10-K*, at 32.

<sup>15</sup> *Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2008*, CS18-08.DOC, at 18-8 (July 1, 2009) (emphasis added).

The “present value of the additional obligation taken on during FY 2008 for future payment” is exactly the current year’s RHB normal costs as determined by OPM.

The Postal Service made clear back in FY 2007 that normal costs are indeed obligations incurred in the year the benefit is earned:

These obligations incurred as benefits earned by employees in FY 2007, will ultimately have to be paid by the Postal Service, and are just as relevant to determining attributable costs, as the salaries and other current benefits paid during FY 2007.

...

Another important element of PAEA on retiree health benefits is that OPM will determine the amount of the new obligations incurred each year (it is the source for the \$3.175 billion estimate for FY 2007, as to be reported in the Postal Service Annual Report).<sup>16</sup>

The OPM has calculated the RHB normal cost pursuant to 39 U.S.C. §3654 every year since enactment of the PAEA, and the Postal Service has included each year’s amount as the accrued current year RHB cost (18.3.6.1) and attributed it to products as a piggyback on direct labor costs in its annual compliance review.

This is notwithstanding the fact that the *funding* of retiree health benefits has varied over the years. Each year, OPM has generated an invoice for the retiree health benefit funding amount required from the Postal Service and the Postal Service recorded that amount in its accounting reports (regardless of whether the Postal Service paid any or all of it). This invoice amount is separate from the RHB normal cost estimated pursuant to 39 U.S.C. §3654. And those invoices, whether paid or not, have been the starting point from which RHB costs

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<sup>16</sup> *Treatment of Annuitant Health and CSRS Benefits Costs*, Docket No. ACR2007, USPS-FY07-2, FY07-2.Supplement.Health.Benefit.Costs.doc, at 1 & 3 (emphasis added).

(Cost Component 18.3.6) presented in the annual compliance reviews have been calculated.

To be sure, the amounts invoiced by OPM (and eventually fed into annual compliance reviews) have differed as Congress modified the funding obligations that it imposed. But regardless of the particular funding requirement in effect in each year and the size of that year's invoice, in its annual compliance reports the Postal Service has *always* attributed incremental RHB normal costs to products by dividing the accounting cost into current year RHB costs and prior year costs, and categorizing the former as either attributable or institutional according to established methodologies not at issue in this proceeding.

In particular, from FY 2007 through FY 2016, RHB expenses due and payable by the Postal Service consisted of employer premiums and statutory prefunding payments. Order No. 6430 at 16.<sup>17</sup> For costing purposes, the Postal Service divided that invoice into current year costs and prior year costs. The Postal Service presented a clear explanation of this process in the FY2007 Annual Compliance Review.<sup>18</sup> For the current year portion of RHB costs, the Postal Service used the RHB normal costs as estimated by OPM pursuant to 39 U.S.C. §3654. Thus, the Postal Service used OPM's Section 3654 calculation of

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<sup>17</sup> From FY 2007 to FY 2016, RHB and Civil Service Retirement System ("CSRS") costs were grouped together in a single cost component. CSRS costs are disregarded herein for clarity.

<sup>18</sup> See *Treatment of Annuitant Health and CSRS Benefits Costs*, Docket No. ACR2007, USPS-FY07-2, FY07-2.Supplement.Health.Benefit.Costs.doc, at 1-2.



RHB normal costs as a foundational component of product attributable costs in every annual compliance review during that period.

In Fiscal Years 2009 and 2011, Congress reduced and deferred, respectively, the prefunding requirement. For FY 2009, Congress reduced the prefunding obligation by \$4 billion. As a result, the earned current year RHB normal costs (the economic costs) exceeded the required payment. Order No. 6430, at 26. The difference was recorded as a negative prior year RHB cost.<sup>19</sup> All incremental RHB normal costs nonetheless were correctly attributed to products in FY 2009. Order No. 6430, at 26. A similar recording of a negative prior year RHB cost occurred in FY 2011 when Congress deferred the prefunding requirement and all incremental RHB normal costs were again correctly attributed to products in FY 2011.

Congress established a different funding arrangement for Fiscal Years 2017 through 2021. For those years, the Postal Service was required to pay RHB normal costs plus amortization payments on the unfunded PSRHB obligation.<sup>20</sup> The total payment required (even if not paid) in those years was the sum of the current year's RHB normal cost and an RHB amortization payment. Mathematically, the amortization payments during this period were equal to the difference between the total RHB payments due and each current year's RHB

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<sup>19</sup> See *Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances (Public Version))*, USPS-FY09-5, Tab "Seg 18," rows 1046 & 1047, Docket No. ACR2009.

<sup>20</sup> Order No. 6430, at 17 & *Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2021* (July 1, 2022, CS18-21.docx, at 18-20.

normal cost. Thus, for example, in the Trial Balance and Cost Segments and Components reports in its annual compliance report for FY 2021, the Postal Service broke down its invoiced amount of \$5.110 billion into the OPM estimated normal cost (18.3.6.1) of \$4.203 billion and a prior year amortization amount (18.3.6.2) due of \$907 million.<sup>21 22 23</sup>

To summarize, in every year since FY 2007, the Postal Service has divided the required RHB payments (regardless of its components) into RHB normal costs (a proportion of which were attributable) and prior year costs (fully institutional). That breakdown has consistently used OPM's estimate of normal costs (per 39 U.S.C. §3654 and reported in the Form 10-K for that year) as the current year RHB costs, which were distributed as either attributable or institutional according to the prevailing distribution of employee costs

Starting in FY 2022, Section 102 of the PSRA replaced the amortization and normal cost payments required by the former PAEA provision with “a new requirement that the Postal Service pay into the PSRHBF for current retiree health care costs equal to premiums minus the cost of annual claims paid.” Order No. 6363, at 10. In other words, the PSRA relieved the Postal Service of the obligation to fund the PSRHBF in FY 2022 and potentially the next few years.

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<sup>21</sup> United States Postal Service, *2021 Report on Form 10-K*, at 80.

<sup>22</sup> *Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances)*, Docket No. ACR2021, USPS-FY21-5, FY21.5 RealTB.Public Redacted.xlsm, “seg 18”, rows 1095 & 1096.

<sup>23</sup> *FY 2021 Public Cost Segments and Components Report*, Docket No. ACR2021, USPS-FY21-2, FY21Public Cost Segs and Comps.xlsx, “CS18”, cells AC60 & AD60.

Instead, Congress provided that the PSRHBF would fund annuitant premiums until it is exhausted, and that no later than FY 2026, the Postal Service may be required to make annual “top-up” payments to the PSRHBF. As OPM issued no invoice in FY 2022, the Postal Service recorded no RHB costs in its FY 2022 accounting documents. That amount of zero flowed through its reporting systems to incorrectly produce in the *FY2022 ACR* a zero for RHB normal costs.

Order No. 6430 addressed the Mailers’ contention that established analytical principles required that the *FY2022 ACR* should include the \$4.4 billion in RHB normal costs calculated by the OPM and reported in the Postal Service’s Form 10-K for FY 2022 and distribute that amount in the normal manner. The Commission acknowledged that RHB normal costs are economic costs incurred in the provision of postal services:

economic costs refer to the retiree health benefit normal costs (even in years when there was not an accounting cost for the normal costs).

Order No. 6430, at 18.

However, Order No. 6430 also noted that the attributable portion of the \$4.4 billion FY 2022 RHB normal cost in the *FY2022 ACR* would exceed the corresponding accounting costs, violating a separate “longstanding analytical principle” that sets total accounting costs as a ceiling for attributed economic costs. Order No. 6430, at 18-19 & 23. Accordingly, the Commission ruled that, under current methodologies, including the RHB normal costs in the *FY2022 ACR* would violate the principle that attributable RHB costs cannot exceed accounting costs:

Given that accounting costs set the limit on the economic costs that can be attributed and no retiree health benefit accounting costs accrued in FY 2022, Order No. 6363 correctly stated that “under the accepted methodology, there are no . . . normal costs to account for in the Postal Service’s financial reporting for FY 2022” and that “[i]ncluding such costs not incurred by the Postal Service would require a change in accepted methodology.”

Order No. 6430 at 24. At the request of Mailers, it then initiated this proceeding to consider changing the principle.

### **III. THE ACCOUNTING COST CAP PRECLUDES ACCURATE COSTING**

As noted, Order No. 6430 found that the current accounting cost cap prohibits the inclusion of incremental RHB normal costs in the product costs reported in the *FY2022 ACR* because including these costs in product costs would result in RHB attributable costs exceeding accounting costs. The Commission did not provide a citation for that principle, other than it was discussed in Docket No. RM2007-1, which established how RHB normal costs would be addressed in Postal Service periodic reports in the PAEA era. *Id.* at 19-20.<sup>24</sup>

It is unclear why in these circumstances attributable RHB costs cannot exceed RHB accounting costs.<sup>25</sup> On the contrary, under the circumstances,

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<sup>24</sup> There is no mention of that principle in the Summary Description for Cost Segment 18 that was adopted in FY 2008, the first after passage of the PAEA, nor does the most recent Summary Description (that for FY 2021) refer to it either. See *Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2021*, CS18-21.docx, at 18-19 (July 1, 2022).

<sup>25</sup> Neither Order No. 6430 nor the Postal Service has argued that the accounting cost cap is required by generally accepted accounting principles, and GAAP accounting differs from accounting for regulatory purposes. The cap may be intended to address possible diseconomies of scale in some postal operations, which conceivably could have resulted in total attributable

attributable RHB costs exceeding accounting costs is the correct outcome. Nor is a negative prior year loss a problem. Accordingly, the accounting cost cap should be removed because it results in inaccurate and understated product costs and thereby prevents the Commission from making accurate determinations regarding the Postal Service's compliance with statutory requirements, costs, and costs avoided by worksharing.

As discussed above, total RHB normal costs *exceeded* accounting (invoiced) costs in both FY 2009 and FY 2011. Furthermore, throughout the periods FY 2007-FY 2016 and FY 2017-FY 2021, any amount by which the required RHB payment (regardless of what elements comprised the invoice) exceeded the actual incurred RHB normal cost provided by OPM was categorized as a prior year cost and treated as a *positive* institutional cost. In a year, such as FY 2022, in which the Postal Service's invoiced payment is less than the RHB normal cost, the result simply would be a *negative* prior year (institutional) cost. That means, all else equal, that the unfunded obligation would increase in that year, which is entirely logical as no payment is required or made while normal costs were indeed incurred. In FY 2022, the Postal Service has made no payment to the PSRHBFB because it received no invoice, but a year's worth of employees earned retiree health benefits.

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costs exceeding accounting cost. But that is a much different scenario than the issue in this rulemaking, which has an accounting cost that has no relationship to an incurred cost.

The *only* difference between FY 2022 and past years is that, when applied to FY 2022, *attributable* RHB normal costs would exceed the funding obligation.<sup>26</sup> That the accounting cost is zero due to legislation does not erase that the obligation was incurred.

And recognizing for regulatory purposes that the absence of an invoice for an incurred obligation leads to an increase in unfunded obligations is hardly nonsensical. As the Postal Service itself explained in 2008: “Advances in the accounting treatment of retiree benefits costs have clearly shown that the costs for retiree benefits should be recognized as they accrue — as employees earning these benefits put in their years of service — rather than at the time of actual cash outlay in the payment of benefits to retirees.”<sup>27</sup>

It is the accounting cost cap that prevents incremental RHB normal costs from being attributed to products in the *FY2022 ACR*, and will continue to do so for at least a few more years. That unavoidably will produce inaccurate results.

#### **IV. THE PROPOSED CHANGE IN ANALYTICAL PRINCIPLES WOULD IMPROVE THE QUALITY, ACCURACY, AND COMPLETENESS OF THE POSTAL SERVICE’S PERIODIC REPORTS**

Commission rule 3050.11 provides that accepted analytical principles may be changed to “improve the quality, accuracy, or completeness of the data or analysis of data contained in the Postal Service’s annual periodic reports to the Commission.” Eliminating the accounting cost cap on Cost Component 18.3.6

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<sup>26</sup> That is likely to happen in Fiscal Year 2023 through 2025, and possibly beyond.

<sup>27</sup> *Treatment of Annuitant Health and CSRS Benefits Costs*, Docket No. ACR2007, USPS-FY07-2, FY07-2.Supplement.Health.Benefit.Costs.doc, at 2.

(Retiree Health Benefits) attributable costs would improve the quality, accuracy, and completeness of reported product costs by including in them the incremental cost of the RHB benefits earned during that year by the employees handling those products.

*Economic costs indicate the true costs of postal operations*

As Order No. 6430 states (at 16), RHB normal costs are economic costs. Economic costs differ from the accounting costs reported by the Postal Service because the economic costs “include costs for benefits as benefits are earned regardless of whether an actual payment is due for the costs (and thus regardless of whether the economic costs are also accounting costs.”<sup>28</sup> Put differently, economic costs indicate the true resources used (including employees) by the Postal Service in providing services, regardless of when the Service is obligated to pay for those costs. As Professor John C. Panzar states in his Statement filed concurrently herewith, “RHB normal costs for future benefits are caused by current volumes of mail to the same extent that current wages are caused by current volumes of mail.” *Statement Of John C. Panzar on Behalf of Mailer Comments on the Appropriate Analytical Principle for Retiree Health Benefit Normal Costs*, at 3 (“Panzar Statement”).

The Commission categorizes economic costs as either attributable or institutional according to standard principles. As shown in Table 1 above, if the \$4.4 billion in RHB normal costs reported in the Postal Service’s Form 10-K were

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<sup>28</sup> *Id.*, at 18.

attributed at a level consistent with levels in recent years, they would increase attributable costs by approximately \$2.6 billion compared to those reported by the Postal Service in the *FY2022 ACR*. That would improve the accuracy and completeness of product costs reported in the annual compliance report by including in them all incremental Cost Segment 18 economic costs, enabling a more accurate assessment of the Postal Service's operational cost performance. It would also improve the quality of the ACR by allowing for apples-to-apples comparisons of product costs between FY 2022 and previous years.

*The accounting cost cap is contrary to the statutory causality standard for cost attribution*

Congress enacted a statutory causality-based standard for cost attribution in 39 U.S.C. §3622 and §3633. Congress defined the term “costs attributable” to mean the “direct and indirect postal costs attributable to such product through reliably identified causal relationships.”<sup>29</sup> As well put by the Package Shippers Association (PSA) in its comments in this proceeding:

Just as the statute forbids the attribution of costs to any product (market dominant or competitive) without the showing of a reliably identified causal relationship between the cost and the product, the statute likewise requires that costs with a reliably identified causal relationship to a specific product be attributed to that product.<sup>30</sup>

Congress established these clear statutory causation-based costing requirements to achieve specific objectives relating to workshare discounts and Competitive products.

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<sup>29</sup> 39 U.S.C. §3622(c)(2); see also 39 U.S.C. §3631(b).

<sup>30</sup> *Comments of the Package Shippers Association*, at 3 (January 4, 2023) .



Congress's definition underlies important statutory requirements. Section 3622(c)(2) states in part that the Commission's regulation of market dominant products must take into account the "requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships." 39 U.S.C. §3622(c)(2). Similarly, Section 3633(a)(1) prohibits the subsidization of competitive products by market-dominant products, which the Commission annually assesses through an aggregate incremental cost test of all costs attributable to competitive products. See 39 U.S.C. §3633(a)(1). Additionally, under Section 3633(a)(2), the Commission must "ensure that each competitive product covers its costs attributable." 39 U.S.C. §3633(a)(2).

These three statutorily required causation-based cost tests cannot accurately be conducted if approximately \$2.6 billion of attributable costs – indisputably earned by postal employees as they worked throughout the year and caused by products – are categorically excluded from product costs.

The accounting cost cap also violates the Commission's own rules implementing these statutory requirements. To determine whether a competitive product covers its incremental costs, "the Commission will calculate a competitive product's attributable costs as the sum of its volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a

competitive product's incremental costs."<sup>31</sup> It cannot calculate those costs correctly unless incremental<sup>32</sup> RHB costs are included in the analysis.

The accounting cost cap appears to be a policy consideration developed by the Commission and Postal Service; the statutory definition overrides conflicting agency-developed practices. There can be no doubt that a portion of RHB normal costs is caused by mail products, as postal employees handle and deliver mail.

*The accounting cost cap conflicts with accrual accounting*

The accounting cost cap conflicts with the Postal Service's accrual accounting as applied to Cost Segment 18. As the Postal Service's own Handbook F-1 states (at 3, emphasis added): "The accrual basis of accounting dictates that the Postal Service record revenues when earned and *expenses when incurred, regardless of when the related assets and liabilities are collected or paid.*"

In these proceedings, the Postal Service has taken the position that RHB normal costs are not "incurred" unless it receives an invoice from OPM. Its labor contracts say something much different, providing that the benefits are earned as employees work regardless of the existence of any invoice. Even the Postal Service recognizes that a cost "consists of an amount someone is required to

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<sup>31</sup> 39 C.F.R. §3035.107(b).

<sup>32</sup> See *Annual Compliance Determination Report, Fiscal Year 2017*, Docket No. ACR2017, at 8 (March 29, 2018) ("In September 2016, the Commission adopted the analytical principle of using incremental costs as the basis for class-level and product-level attributable costs." (footnotes omitted)).

pay.”<sup>33</sup> The Postal Service’s obligation to pay those costs is not absolved simply because it did not receive an invoice in FY 2022 as Congress chose to spend down the PSRHBFB instead. The more accurate position for accrual accounting is that the expenses are incurred as employees work, not when an invoice for those costs eventually arrives.

Using the OPM calculation of RHB normal costs as the current year RHB costs in the Postal Service’s periodic reports would improve their accuracy compared to the current treatment of Order No. 6430. It would do so by tying the costs in the periodic reports more directly to when employees in fact earn the benefits, than on the timing of invoices set by Congress. It would also produce a more stable number appropriately tethered to cost causality year-to-year, rather than subject to jumping from zero to some number depending on OPM’s calculation of amounts needed to “top-off” the fund.

*Economic costs are necessary to implement Efficient Component Pricing properly*

Including incremental RHB normal costs in the product costs and resulting workshare cost avoidances reported in annual compliance reports would also improve their accuracy by providing the most accurate information to implement the Commission’s long-standing policy of efficient component pricing of workshare discounts.<sup>34</sup> The Commission has long recognized that “[r]ates that

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<sup>33</sup> *Response of the United States Postal Service to Mailers’ Motion for Reconsideration and Petition*, at 7-8 (January 4, 2023) (emphasis in original).

<sup>34</sup> The Commission’s use of ECP principles in setting workshare discounts predates the effective date of the PAEA. *See Opinion and Recommended Decision*, Vol. 1, Docket No. R2006-1, at ii (February 25, 2007) (stating “The Commission has used Efficient Component

send proper price signals result in more efficient processing and transportation practices, which in turn reduce costs, thereby allowing smaller rate increases, and less volume losses.”<sup>35</sup> More recently, the Commission reiterated that ECP requires workshare discounts to “be set equal, on a per-unit basis, to the costs avoided by the Postal Service when the mailer performs the workshare activity.”<sup>36</sup>

Applying ECP correctly requires accurate postal costs. When setting prices efficiently using ECP, the costs avoided “must be economic – i.e., avoidable costs.” *Panzar Statement* at 7. That means “the attributable costs of the Postal Service must include all of the Postal Service costs that would disappear if the mailer performed the work instead.” *Id.*

The current principle produces incomplete and understated product costs that are not the costs that make ECP produce efficient outcomes. Omitting a portion of the direct and indirect labor costs from the calculation of avoided costs would unavoidably result in underestimates of cost avoidances, which in turn would lead to inefficiently priced workshare discounts.<sup>37</sup> NPPC cited numerous

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Pricing to develop rates wherever possible. Many rates proposed by the Postal Service were not consistent with Efficient Component Pricing as they failed to reflect cost differences fully”).

<sup>35</sup> *Id.*

<sup>36</sup> Order No. 4258, Docket No. RM2017-3, at 89 (December 1, 2017).

<sup>37</sup> See *Panzar Statement* at 8 (using illustration of how the Postal Service’s economic costs would not change whether or not it purchases an insurance policy to cover worker future retirement liabilities, but using accounting costs would set an erroneous signal). If a particular workshare activity results in the Postal Service needing fewer employees, then the Postal Service saves labor costs, including RHB normal costs, from the reduction in staffing immediately and without waiting for an invoice. For workshare discount pricing accuracy, those reduced costs should be reported in the year that they happen, not at some future time when OPM sends an invoice reflecting those costs.

examples of these errors in its recent comments on the Postal Service's *FY2022 ACR*.<sup>38</sup>

The harm resulting from not properly attributing RHB normal costs in FY 2022 would not be mitigated if the treatment of normal costs were to be corrected in a future year. Current discounts are used as inputs in establishing subsequent discounts. Distortions in current discounts, even if temporary, would thus result in future distortions, notwithstanding any correction of the treatment of normal costs in the future.

Relatedly, including incremental RHB normal costs in workshare cost avoidance estimates promotes pricing fairness with private mail preparation firms. Those firms also incur employee liabilities and do not have the advantage of Congress legislating away their payment obligations for a few years. Including RHB normal costs at the time they are earned “promotes fair competition, because it allows mailers to determine if they can prepare the mail at a lower cost than paying the Postal Service to do the work.”<sup>39</sup>

## **V. CONCLUSION**

For these reasons, the Commission should approve NPPC *et al.* Proposal One, as discussed above. The proposal would improve the “quality, accuracy, or completeness” of the costs reported in Annual Compliance Reports. Accordingly,

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<sup>38</sup> *Comments of the National Postal Policy Council*, Docket No. ACR2022, at 7-8, Tables 1-3 (January 31, 2023).

<sup>39</sup> Order No. 4257, Docket No. RM2017-3, at 131 (December 1, 2017).

the undersigned Mailers urge the Commission to change the analytic principle in that manner, and upon doing so to require that incremental RHB normal costs be attributed to products in the Annual Compliance Report for FY 2022 and in future years as required by law and Commission rules.

Respectfully submitted,

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